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Deloitte.

FINANCIAL CRIME IN THE MIDDLE EAST AND NORTH AFRICA 2015

The Need for Forward Planning

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TABLE OF CONTENTS

INTRODUCTION

This survey of financial crime programs in the MENA region, a joint initiative of Thomson Reuters and Deloitte, is the first of its kind and will form a baseline for a longitudinal study. Over the next few years we envision that this survey will grow in breadth and depth, but the core questions will remain, allowing us to track changing priorities and activities in the region.

The survey results and analysis can be used by regulated firms to help with benchmarking, planning and resourcing in the future, and we are grateful for respondents' participation and for their open and candid views.

More than 160 practitioners involved in compliance across the corporate and financial sector in the MENA region responded anonymously to our survey, which began in November 2014, reflecting the broad range of businesses present in the region. Around 30% of respondents came from companies with more than 1,000 employees and 60% belonged to companies that had a presence in two or more countries. The results of the survey are considered reflective of the region with more than two thirds of the respondents being actively involved in setting financial crime policy or lead a team that works on financial crime policy for their organizations.

After analysing the results, we noted a number of themes had emerged:

- Compliance departments are juggling competing priorities
- The only constant is change while there is an increasing demand on budget and resources
- Reputation is critical
- Low levels of confidence in existing compliance programs
- Compliance officers are investing in technology rather than skills to help them meet their compliance challenge

With the tide of regulatory change not expected to turn in the medium term, combined with budgetary and resource constraints and the ongoing pressure to balance business objectives with regulatory requirements, we were not surprised that survey results show that compliance officers in the region are experiencing a certain amount of pressure.

COMPETING PRIORITIES

As expected, we found that there were several competing priorities for compliance officers in the MENA region including Anti-Money Laundering (AML), sanctions, fraud and Counter Terrorist Financing (CFT). This is in keeping with international trends and reflects the direction of most international legislation and enforcement activity.

Interestingly, whilst we have seen progress globally in the fight against bribery and corruption in recent years, the existence of Anti-Bribery and Corruption (ABC) policies continues to lag behind for organizations in the region, and levels of concern are slightly lower for this issue. This is expected to be addressed in the short term though as local economies continue to integrate with the wider global community. It is clear through recent enforcement activities that certain international authorities are drawing a line in the sand when it comes to bribery and corruption, and claiming ignorance of regulations is no longer considered an acceptable defence.

Perhaps the most noteworthy concern was the absence of cyber-security programs within organizations - this initiative lagged significantly behind the others despite the issue currently topping the global agenda due to the high level of risk it represents. Globally, cyber-crime continues to be an emerging risk, with regular media reports now relating to hacking, data losses or breaches and other information leaks.

As a region known for its financial services and energy interests, the MENA region poses an attractive target for cyber criminals. Industry research reveals ongoing and increasing cyber-security threats in the Gulf Cooperation Council (GCC) region, which we have seen manifest in recent phishing attacks in Saudi Arabia and malware attacks on UAE's banking system. With the increasing focus on cyber-security by prominent experts, authorities and media houses, the apparent lack of policy on the issue appears counter intuitive but may be reflective of a deficiency in clear and active local regulation.

This looks set to change soon however, as international governments push this issue to the top of their political and legislative agenda. We expect this will become an increasingly prominent concern for companies in the MENA region, particularly as the survey results indicate a high and growing level of reliance on technology being used to fight financial crime.

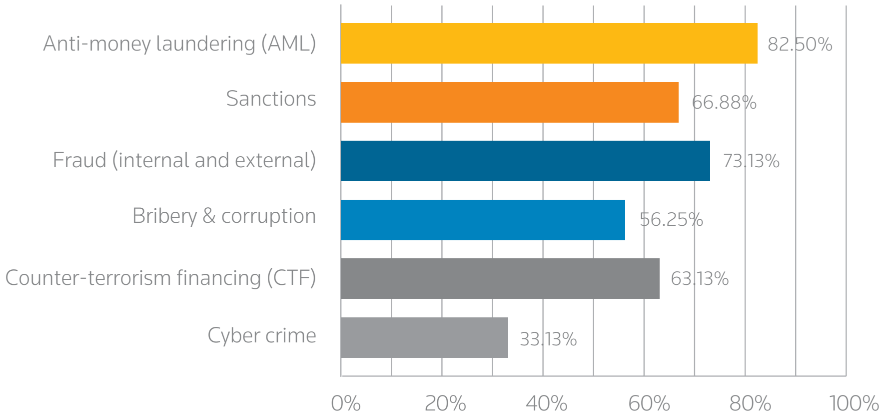
"We've got to stay ahead of those who would do us harm. Cyber threats are an urgent and growing danger."

President Barack Obama

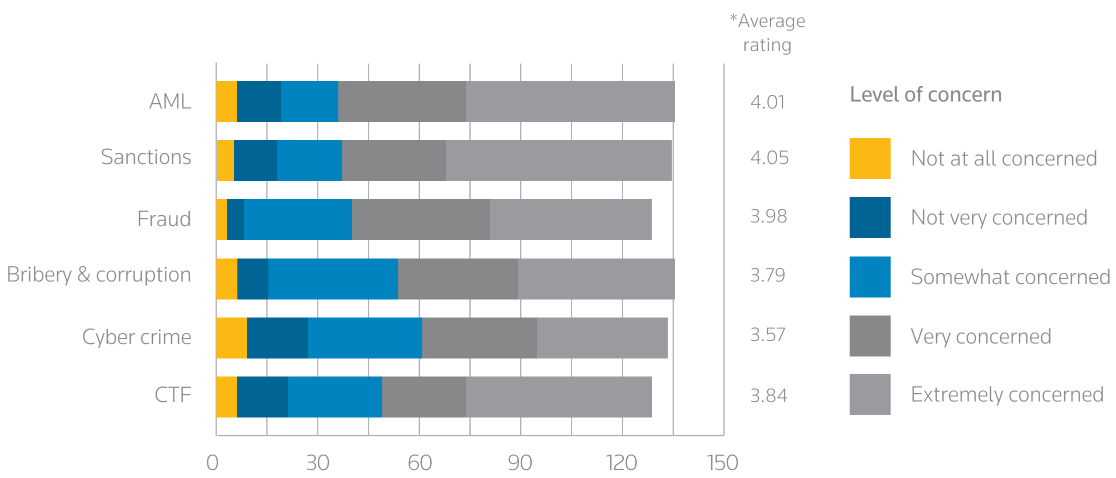
National Cyber-security and Communications Integration Center
January 13 2015

QUESTIONS

Which of the following financial crime initiatives or policies does your organization currently have in place? Please select all that apply.



Please indicate how concerned your organization is about the following financial crime issues?



CONCERTED EFFORTS TO REDUCE SECURITY THREAT

International authorities will step up their action against the transnational threat of militant organizations, especially those that continue to conduct and threaten attacks in major European centres. We are likely to see increased regulation that will impact on AML, CFT and KYC processes.

* Weighted average indicates level of concern.

THE ONLY CONSTANT IS CHANGE, AND THERE IS AN INCREASING DEMAND ON BUDGET AND RESOURCES

While we know that change has been the one constant feature of the regulatory environment, the sheer level of regulatory change is perhaps not always appreciated. Over the past 15 years, regulation has changed almost out of all recognition as policy measures designed to minimize the risk of another financial crisis and curtail financial crime proliferate.

It is clear that compliance departments are impacted by the ongoing stream of regulatory change, both domestically and internationally; and compliance practitioners expect this to continue for some time. 85% of respondents have seen anti-crime and compliance activities increase in the last two years, whilst less than 6% of respondents believe that their compliance policy will stay the same over the short term.

75% of participants surveyed expect that compliance related costs will continue to increase in the short term with technology (26%) and process improvement (22%) standing out as key tools organizations are investing in to manage compliance risks. This highlights the drive for greater efficiency in a time where budgetary pressures continue to exist. Technology continues to be the most efficient method of managing 'business as usual' processes such as transaction monitoring. The use of regulatory intelligence is also becoming more prominent as firms seek to balance the cost of compliance with the need to remain vigilant on combating financial crime. Whilst historically it has tended to be used as a reactive measure, as with most compliance activity, the true benefit of this work comes with undertaking it proactively.

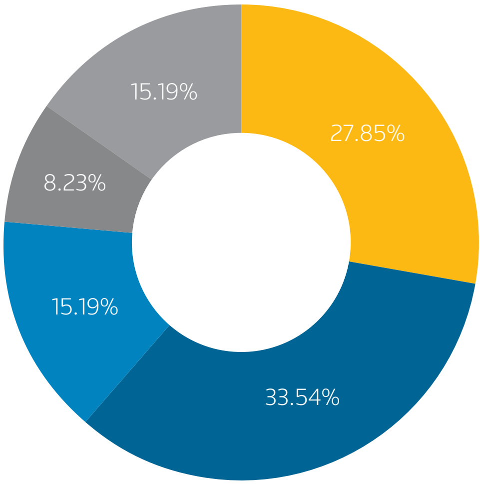
So, whilst the future of financial crime management appears to be in the use of technology, businesses in the MENA region need to ensure they are not overly reliant on it. We expect that effective compliance programs will continue to demand a balance of technology with human intervention to manage the risks associated with operating in the region.

COST OF COMPLIANCE

The survey's findings about rising costs are in line with international trends. Thomson Reuters worldwide Cost of Compliance Survey 2014, which encompassed more than 70 countries, showed that two-thirds of respondents were expecting the cost of senior compliance to increase in 2014 with over a fifth (21%) expecting costs to rise significantly.

QUESTIONS

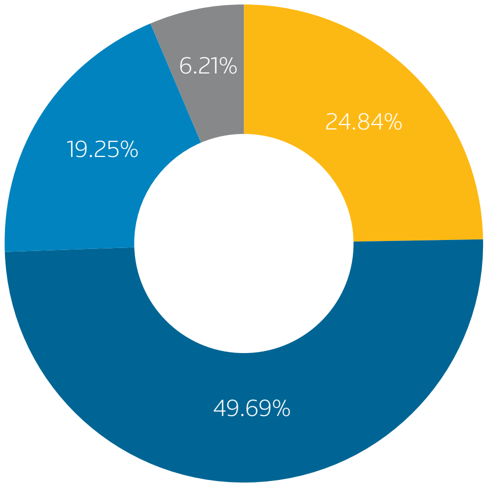
How much has your organization's investment in anti-financial crime activity and compliance increased compared to two years ago?



Compliance increase

- Substantially, over 50%
- Negligible, over 10%
- Somewhat, over 25%
- Not at all
- Don't know

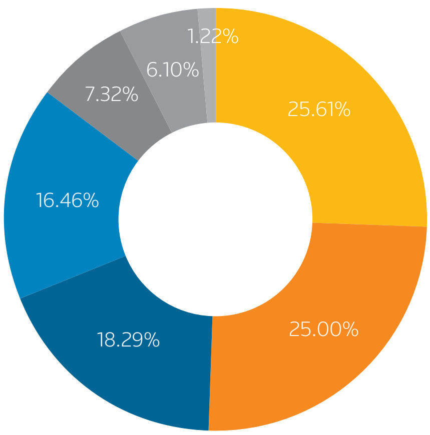
How do you anticipate the increase in anti-financial crime activity and compliance investment over the next two years?



Compliance increase estimation

- Substantially, over 50%
- Negligible, over 10%
- Somewhat, over 25%
- Not at all

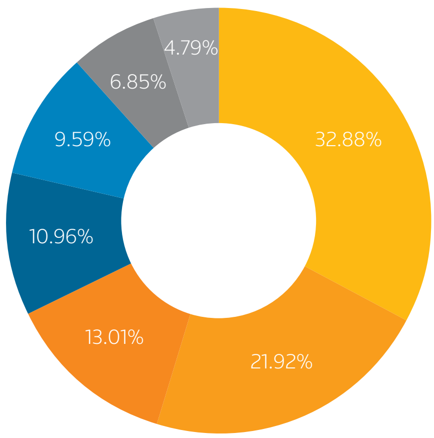
Has your organization's anti-crime and compliance activity increased in the past two years?



Activity increase

- Yes we are spending more personnel hours in the pursuit of compliance objectives
- Yes we have introduced new processes to achieve compliance obligations
- Yes we have increased staff resources with direct application on compliance activities
- No there is no difference from before
- Don't know
- Yes we spend more time monitoring regulatory updates and change
- Other (please specify)

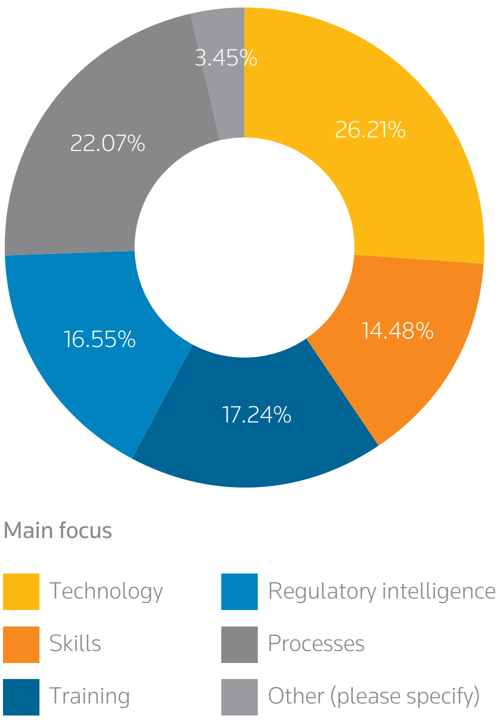
Do you expect your organization's anti-crime and compliance activity to increase in the next two years?



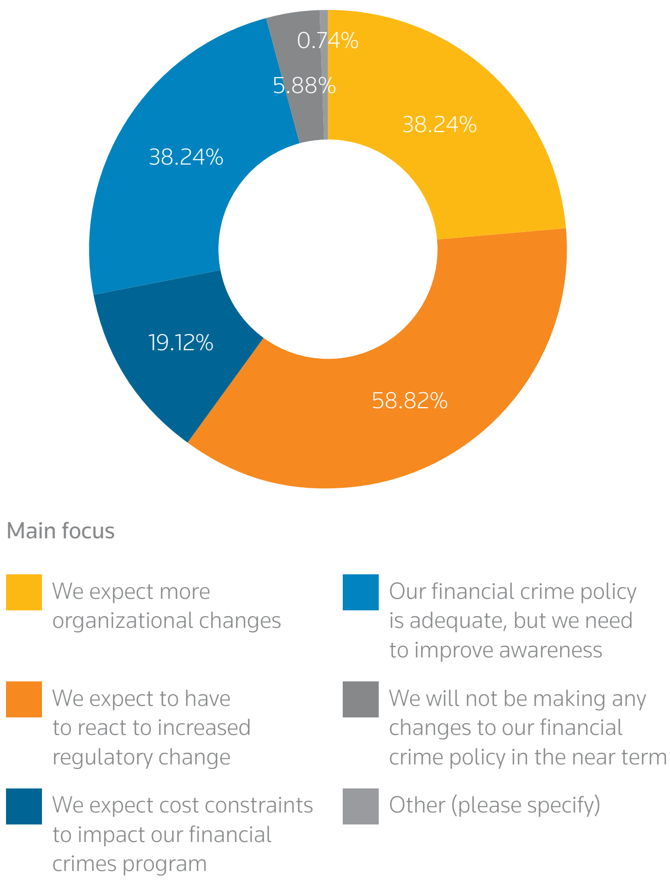
Activity increase estimation

- Yes we expect our personnel hours to increase in the pursuit of compliance objectives
- Yes we understand that we have to plan for new processes to achieve compliance obligations
- Yes but I'm not sure how
- Yes we plan to increase staff resources that have a direct application on compliance activities
- No we expect our staff levels and time commitment to remain the same
- Yes we believe we will spend more time monitoring regulatory updates and change
- Don't know
- Other (please specify)

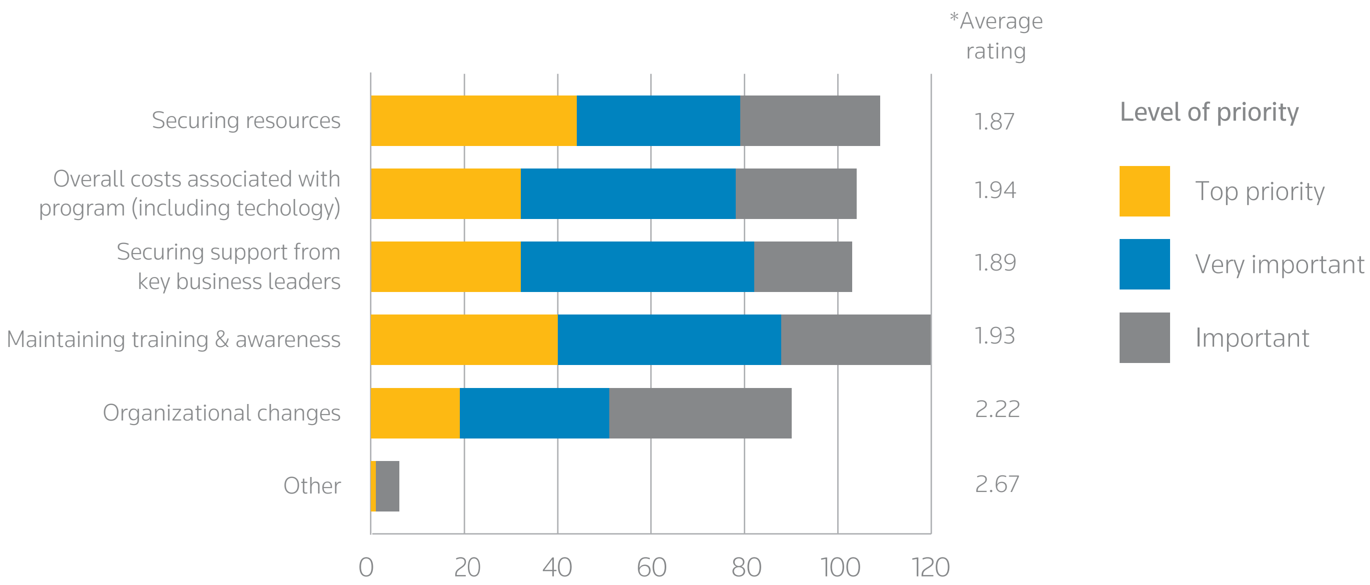
What is the main focus of your organization's investment to meet compliance objectives?



Thinking about the next two years, which of the following statements best describes your organization's approach to its financial crime and regulatory obligations? Please select all that apply.



Over the next 2 years, what do you believe to be the greatest challenges that your organization will face in managing your financial crime and compliance programs? Please rank in terms of priority. Do you expect your organization's anti-crime and compliance activity to increase in the next two years?



* Weighted average indicates level of priority.

"The events which have shaped the evolution of financial regulation include crises, scandals, innovation and liberalization. Each has elicited a response, typically the addition of a new regulatory layer. The cumulative consequence has been a regulatory tide which has tended to flow in only one direction towards a lengthier, more complex rulebook."

Andrew Haldane

Executive Director, Financial Stability and Member of the Financial Policy Committee, Bank of England, at the International Financial Law Review Dinner, April 2013

REPUTATION IS CRITICAL

More so than financial loss, the risk of reputational damage is the number one concern for respondents to our survey. The survey results also highlight that meeting business objectives remains a competing priority.

That the competing priorities of managing reputation risk and furthering business objectives should be at the top of their list is reflective of the ongoing transformation of organizations in many economies across the MENA region. Banks in the GCC, for example, have had a traditionally low customer penetration rate and are changing their focus to attract and retain customers from untapped markets. In this environment, differentiation is important, which means that reputation is vital. The loss of correspondent banking relationships for compliance related reasons will also continue to limit the ability of region financial institutions to operate in a truly global capacity.

We have already witnessed the impact of reputational degradation on a regional bank. Following increased scrutiny by US authorities of the banking system in Lebanon, a large bank operating in the country was labelled a "prime money laundering concern" by the US OFAC in February 2011. Despite the protestations of its senior executives, the bank was unable to absorb the damage and later went into receivership.

Maintaining business integrity while balancing competing priorities will therefore remain a key challenge for organizations in emerging markets for some time.

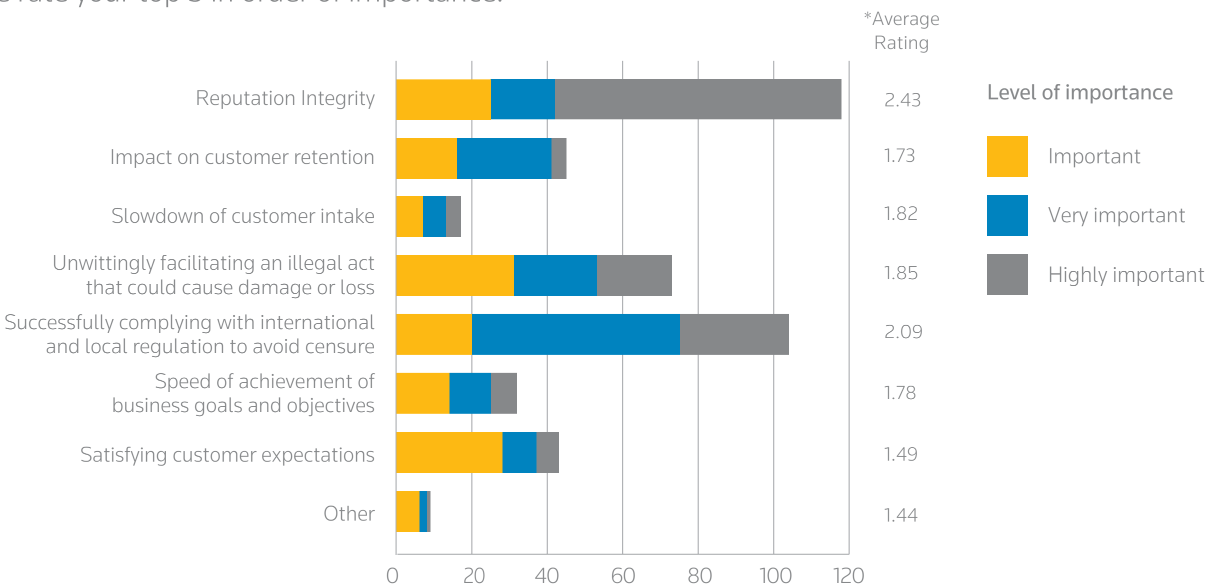
"There are some known facilitators, for example lawyers in shell company jurisdictions etc., that know very well how to use the international financial system to assist with that kind of grand corruption."

Tom Keatinge

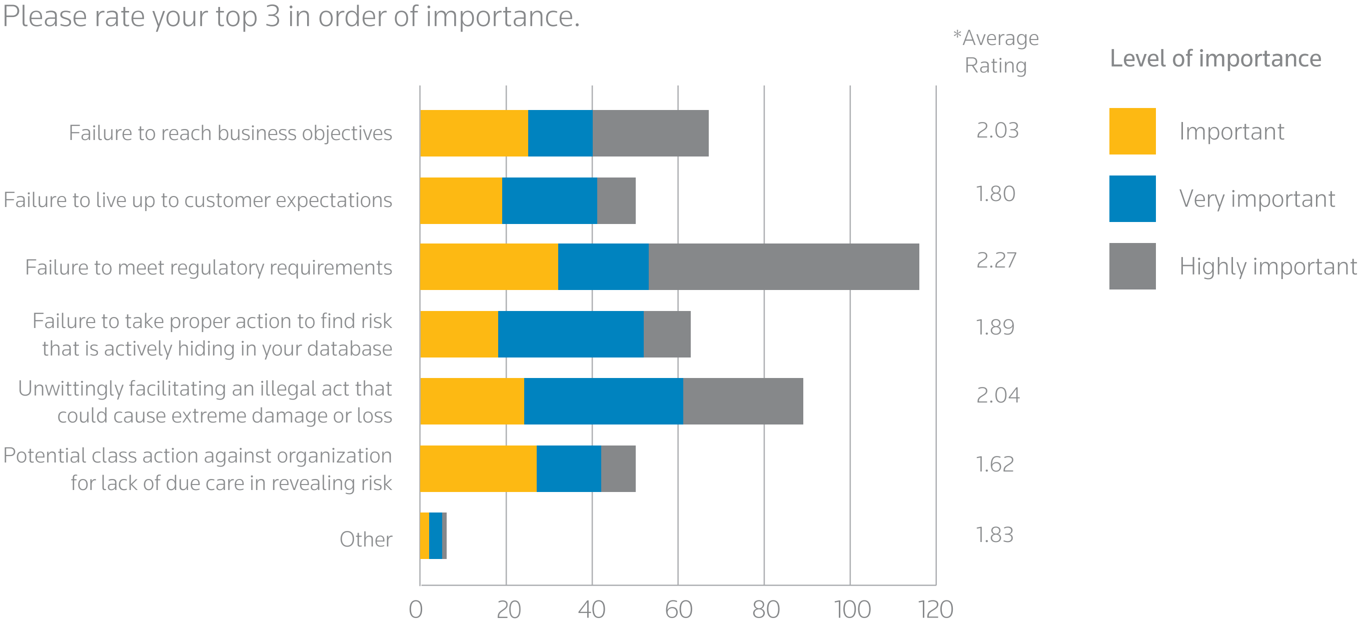
Associate fellow at the Royal United Services Institute (Rusi)

QUESTIONS

What do you believe is the key concern for your organization in terms of financial crime and compliance? Please rate your top 3 in order of importance.



What, in your opinion, poses the most substantial risk to your organization? Please rate your top 3 in order of importance.



* Weighted average indicates level of importance.

LOW LEVELS OF CONFIDENCE IN EXISTING COMPLIANCE PROGRAMS

One of the most concerning themes to be highlighted by the survey was the confidence level respondents placed in their existing financial crime management programs. Almost half of those surveyed highlighted a lack of confidence in the effectiveness of their existing financial crime programs when compared with both domestic and international regulatory requirements. Similarly, 57% of respondents questioned the ability of their compliance policy to prevent illicit activity.

Such low levels of confidence are noteworthy, particularly given the majority of the respondents are responsible for setting and guiding corporate compliance policy. This is concerning because many locally established financial institutions are actively looking to expand their presence globally, either by expanding into other jurisdictions or through the acquisition of customer bases. As worrying as this is, this finding is in line with international trends and reflects an ever changing regulatory environment, combined with an absence of structured and robust regulatory guidelines in certain jurisdictions.

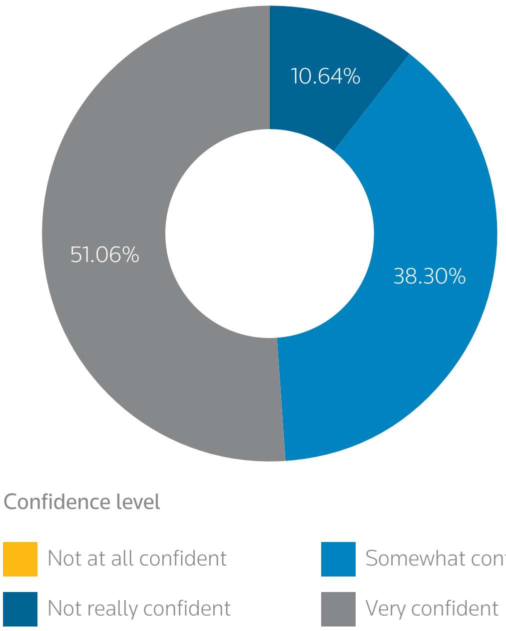
If financial crime programs are not meeting the current regulatory needs, their ability to support ongoing strategic or operational change in a time of ongoing regulatory uncertainty poses a key risk. The responses also point to the potential for vulnerability to the impact of financial crime. Financial crime can be linked to terrorist funding, so should a financial institution be so implicated, it can result in a devastating fine and loss of reputation.

Such weaknesses also highlight the importance of the culture of compliance management within organizations. Comprehensive and well written policies are ineffectual and meaningless in light of the increasing demand by regulatory agencies that organizations demonstrate how they have effectively embedded policies into the business. This shows us that, without proper controls and accountability, compliance policies that look good on paper can fail, and when they do fail, the consequences can be considerable.

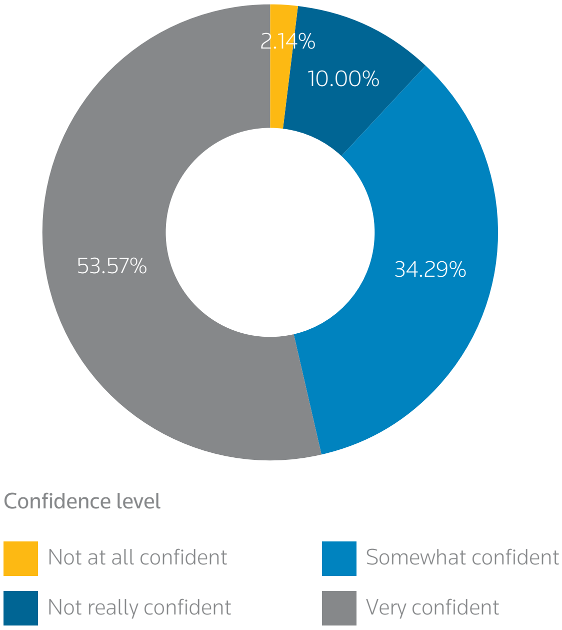
> "60% of a company's market value is derived from its reputation"
>
> **The Company Behind the Brand: In Reputation We Trust**
> Weber Shandwick 2011

QUESTIONS

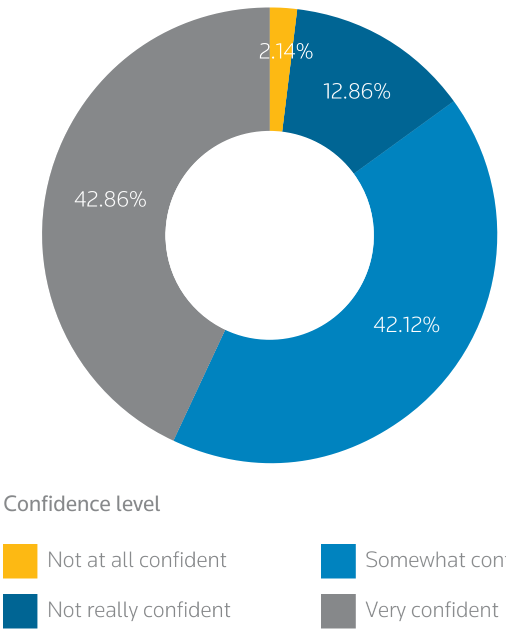
How confident are you that your organization's financial crime prevention programs achieve their objectives, i.e.. help to prevent crime and comply with domestic regulatory requirements?



How confident are you that your organization's financial crime prevention policy is compliant with all your international regulatory requirements and expectations?



How confident are you that your organization's financial crime prevention policy is preventing the type of illicit actions and transactions that would otherwise cause significant damage?



WITHOUT PROPER CONTROLS

Effective compliance policies that look good on paper can fail, and when they do fail, the consequences can be massive.

In 2012, the European and Middle East operations of a major international bank was found to have manipulated its own compliance procedures by editing details contained in transactions, which may have, according to the US Senate, facilitated illicit financial flows.

HOW WILL COMPLIANCE OFFICERS CONTINUE TO MEET THE COMPLIANCE CHALLENGE?

From responses, it appears that executives in the region are meeting their compliance obligations mainly through a combination of technology and due diligence and customer profiling processes. In particular, sanctions, fraud and ABC program management depend on due diligence and technology, whilst AML programs mainly use customer onboarding and profiling and due diligence to reveal risk. CFT relies on suspicious transaction reporting and technology, and of course, cyber-security is largely technology based.

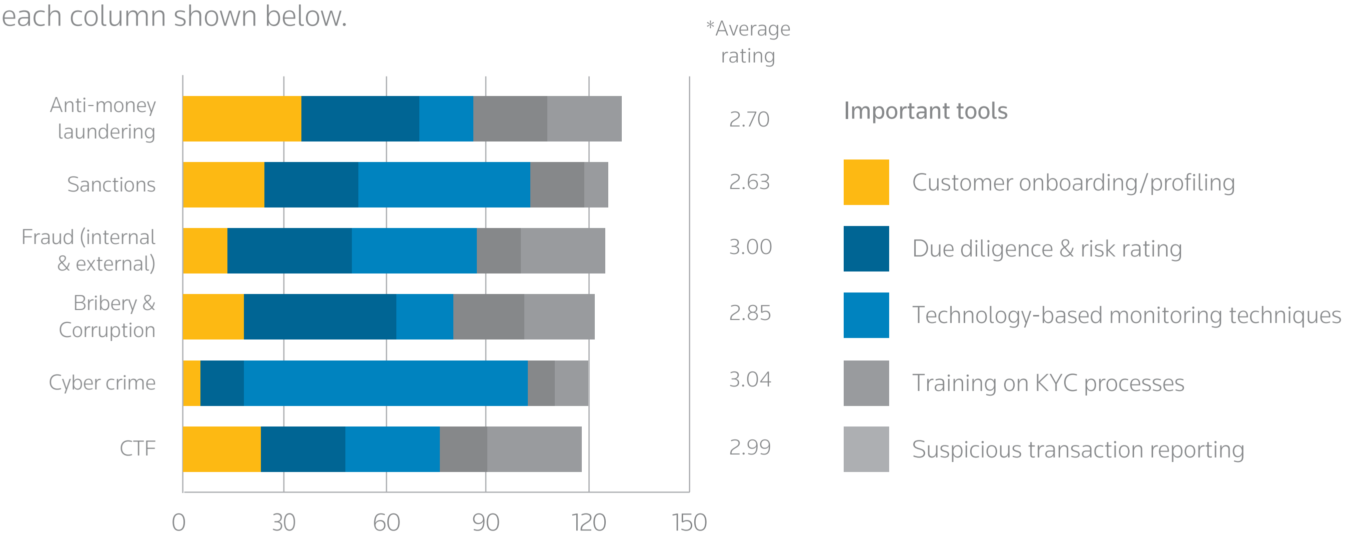
The survey results also indicated a low level of training on Know Your Customer (KYC) processes across all programs. This is of concern given that fighting financial crime demands a multi-faceted and carefully considered approach, and knowing your customer is the bedrock of a sound compliance program.

Understanding what to focus on in the KYC process can substantially increase the effectiveness and efficiency of a compliancy program. KYC is therefore a critical building block in the compliance challenge, and requires specialist understanding. As the regulatory environment has evolved over the past decade, KYC processes have increased in their complexity and now require a more sophisticated response.

We expect KYC to become increasingly central to regulatory and tax compliance in the future, which means that human capital and specialist skills in this area will continue to be sought after. The organizations that succeed will be the ones that are investing in these areas now.

QUESTIONS

For each of the programs listed, please indicate what you believe to be the most important tool in managing the prevention and / or detection of financial crime. Please select one answer in each column shown below.



INCREASINGLY, AUTHORITIES ARE LOOKING AT EXECUTIVE RESPONSIBILITY

In December 2013, a major UK based bank received a substantial fine for processing transactions of regimes and entities subject to international sanctions. Furthermore, several senior executives, including the head of banking services for Asia, Middle East and Africa, were dismissed for misconduct.

* Weighted average indicates level of importance.

CLOSING THOUGHTS

In 2015, compliance officers will have to think about how to do more with less. More will be expected of them, yet it will become increasingly difficult to stay abreast of the changing demands of the regulatory environment.

The need for compliance officers to anticipate regulatory change, think smarter about managing the associated risks and maintain the visibility of regulatory efforts at a high managerial level has never been greater.

The relationship and communication between the compliance officer and the board will thus play an increasingly important role. It's vital that the board understands the value of the compliance function and help to communicate this throughout the organization. This will also help to ensure a fair budgetary allocation, as any organization with limited or inadequate resources may struggle to fulfil its compliance mandate and may face enforcement action.

At the same time, compliance officers need to challenge regulators to provide robust regulatory support that will help manage the fight against financial crime.

It is increasingly evident that compliance needs to become central to operations, not merely a back office function, and continuing communication between the compliance function and both internal and external stakeholders is crucial in this respect.

We look forward to tracking the progress of financial crime management by organisations across the MENA region in next year's survey.

BUILD A SOLID COMPLIANCE PROGRAM IN 2015

- Manage personal regulatory risk – enforcement activities increasingly focus on personal liability, so gain an understanding of levels of exposure for senior executives, and plan how best to manage it.
- Build relationships with regulators – create a strategic management plan for regulatory interactions which provides valuable insight to regulatory expectations.
- Produce sound, clear reporting – produce reports that have practical intelligence, that are user friendly, straightforward and consistent and ensure that they are well evidenced.
- Review your policies regularly – market changes and regulatory updates create a dynamic environment, authorities look to see that your policies are well thought out and responsive to your context, so build in a regular, periodic review of policies.
- Build capacity and skills for the future – compliance skills are already sought after and the demand for expertise will escalate, start planning a skills database now.

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Thomson Reuters Accelus connects business transactions, strategy and operations to the ever-changing regulatory environment, enabling firms to manage business risk. A comprehensive platform supported by a range of applications and trusted regulatory and risk intelligence data, Accelus brings together market-leading solutions for governance, risk and compliance management, global regulatory intelligence, financial crime, anti-bribery and corruption, enhanced due diligence, training and e-learning, and board of director and disclosure services.

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